that form with the Commission.[87] BellSouth concurs with this requirement. It clearly satisfies the requirement of Section 274(f) with minimal burden on a separated affiliate that is already required to prepare and file SEC Form 10-K.

The Notice also recognizes that not all separated affiliates will be required to file a Form 10-K with the SEC. Indeed, most separated affiliates providing electronic publishing will not be subject to the SEC 10-K requirement. Consequently, as an alternative to a SEC Form 10-K, the Notice seeks comment on what type of filing requirement would be "substantially equivalent."

The legislative history sheds little light on the filing requirement for entities that are not required to file an SEC Form 10-K. The Joint Explanatory Statement merely states that the report should be "similar" to Form 10-K.[88] Under these circumstances, the Commission has considerable discretion in formulating a reporting requirement for electronic publishing entities.

Form 10-K contains selected financial and operating data, management analysis of business trends and results of operations, financing activities, legal proceedings, comprehensive audited GAAP financial statements and footnote disclosures, employee compensation and benefits. Much of this information is designed to protect investors of publicly traded entities. These requirements are not intended to meet the ratepayer protection objectives of the 1996 Act. BellSouth believes that the Commission should compare the contents of Form 10-K with the specific requirements of Section 274, and

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[87] Notice, para. 108.

[88] Joint Explanatory Statement of the Committee of Conference, Conference Report on S.652, CR-156.

require the separated affiliate to file only that information that is relevant to the concerns outlined in Section 274, not Form 10-K.

The Commission should adopt a standard reporting format applicable to all electronic joint ventures. BellSouth recommends that the report contain a description of the entity filing the report, summary financial statements with representations of management, a list of the officers and directors of the entity, a description of any financing activity undertaken, and specific transactional compliance results obtained from the annual compliance review required by Section 274(b)(8). Such a report will provide the Commission and the public with the basic data necessary to evaluate the operations of the separated entity without requiring the formulation and disclosure of Form 10-K information that would be burdensome to develop and the disclosure of which could be competitively damaging.

Section 274(b)(9) expressly recognizes the need to protect proprietary information contained in the compliance report. The Commission should extend that protection to the report required under Section 274(f).

d. Section 274 Transactional Requirements

The requirements of Section 274(b)(1) that the separated affiliate or joint venture "maintain books, records, and accounts and prepare separate financial statements" is a straightforward requirement that requires no additional rules by the Commission.[89] The Commission should simply require that the accounting comply with GAAP. Section 274(b)(3) requires that the entity be operated independently from the BOC and that transactions be carried out "in a manner consistent with such independence." This

[89] Notice, para. 109.

requirement should be interpreted to mean that such transactions comply with the existing affiliate transaction rules so long as such rules are deemed necessary by the Commission.[90] No additional rules are required to implement this provision. The requirement in Section 274(b)(3)(C) is satisfied if the separated affiliate or joint venture maintains its books in accordance with GAAP.[91] The requirements of Section 274(b)(4) are satisfied through compliance with the Commission's asset transfer rules.[92] Thus, no additional rules are required to implement the requirements of Section 274(b)(1)-(4).

e. Scope of Commission's Authority

The reference in Section 274(b)(4) to "regulations as may be prescribed by the Commission or a State commission to prevent improper cross-subsidies" should be read consistently with Section 220(a) of the Communications Act and with Louisiana Public Service Commission v. FCC, 476 U.S. 355 (1986).[93] A reading of the statute consistent with the other provisions of the Act and the jurisprudence would allow the Commission to prescribe the Part 32 uniform system of accounts, including the affiliate transaction rules contained in Section 32.27, that would bind all carriers subject to Part 32.[94] The State commission, however, could adopt additional, complimentary accounting requirements, and would not be bound to use the results of Part 32 accounting for state ratemaking purposes. Nothing in Section 274 purports to give the Commission plenary jurisdiction over electronic publishing services.[95]

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[90] Notice, para. 110.
[91] Notice, para. 111.
[92] Notice, para. 112.
[93] Notice, para. 114.
[94] Notice, para. 115.
[95] Notice, para. 116.

f. Miscellaneous

BellSouth concurs with the tentative conclusion in the Notice that compliance by a BOC with the affiliate transaction rules is sufficient to ensure compliance with the requirements of Section 274(d) that rates for network access and interconnection be just and reasonable.[96] As discussed earlier in these comments, BellSouth strongly opposes those changes in the asset transfer rules that would eliminate prevailing company price as a valuation method, and that would require application of the asymmetrical asset transfer rules to services transactions. Both of these changes are totally inappropriate, and neither is required to comply with the requirements of Section 274(d) of the 1996 Act. BellSouth also believes that the discussion of tariffed-based valuation in response to Paragraph 86 of the Notice is equally applicable to the separated affiliate or joint venture under Section 274(d).

4. Separated Operations under Sections 260, 271, 275 and 276

The issues raised in Paragraphs 118 and 119 of the Notice have been discussed in detail earlier in these comments, and BellSouth will not repeat its arguments here. It is sufficient to note that BellSouth has demonstrated that the existing affiliate transaction rules, as applied to price cap LECs, are no longer necessary and should be abolished. If the Commission retains these rules, they are more than sufficient to protect the public interest, and the additional, onerous requirements proposed in the Notice are unnecessary and directly contrary to the deregulatory purposes of the 1996 Act. If the unduly burdensome changes in the affiliate transaction rules proposed in the Notice are adopted, they should be limited to those new affiliates required to be formed under the 1996 Act.

[96] Notice, para. 117.

The existing affiliate transaction rules should be applied to existing affiliates, and those new affiliates that the BOCs choose to, but are not required to, establish under the 1996 Act. As BellSouth has shown above, the Commission should read Section 260 as the provision governing BOC provision of interLATA telemessaging services, and should not impose a requirement that such services be provided through a separate affiliate.

The Commission's statement, "Because interLATA telecommunications services present a potential for improper subsidization..." is unsupported and erroneous. BellSouth has shown herein that there is no incentive on the part of price cap BOCs to subsidize its interLATA affiliate, and no opportunity or incentive for the interLATA affiliate to subsidize the BOC. Both carriers remain subject to the requirements of Title II, and there is no justification for extending the affiliate transaction rules to transactions between two regulated entities, or adopting new rules applicable to such transactions.

IV. OTHER MATTERS

A. Price Caps

It is unfortunate that the Commission has seen fit to bury its discussion of the relationship between price caps and the need for cost allocation and affiliate transaction rules at the end of the Notice.[97] That discussion should frame the Commission's entire analysis of the continuing need for cost allocation and affiliate transaction rules for the BOCs and other price cap LECs. If the Commission takes a hard, objective look at the incentives that price cap regulation was designed to produce, and considers that the price cap LECs have been operating under such regulation for more than six years, it should be apparent that the cost allocation and affiliate transaction rules are simply unnecessary

[97] Notice, paras. 120-124.

vestiges of cost of service regulation. These rules are costly to implement and discourage carriers and their affiliates from engaging in valuable, efficiency-enhancing transactions that have no real potential to adversely affect customers.

The fact that to date the Commission has seen fit to retain vestiges of cost-of-service regulation in the LEC price cap plan should not be used as an excuse to retain the cost allocation and affiliate transaction rules. Even if a price cap LEC is subject to sharing or exogenous cost adjustments, or if the Commission retains the ability to adjust the productivity offset in the future, these elements do not eliminate the cost-cutting, efficiency enhancing incentives that predominate under price cap regulation. To suggest that a carrier like BellSouth, that has elected the no-sharing price cap option and that is currently priced well below the price cap, would attempt to manipulate affiliate transactions or cost allocation to shift costs, is simply unrealistic. The Commission's refusal to let go of unnecessary regulation is contrary to Congress' intent, and contrary to the public interest.

BellSouth has long advocated that the sharing backstop be eliminated from the LEC price cap plan. But whether sharing is eliminated or not, the Part 64 cost allocation rules are unnecessary, costly, and contrary to sound economics and proper efficiency-enhancing incentives. These rules should be eliminated in this proceeding.

B. Section 254(k)

As BellSouth has demonstrated throughout these comments, the price cap rules essentially eliminate any incentive or ability of price cap carriers to use "services that are not competitive to subsidize services that are subject to competition."[98] With the

[98] Notice, para. 125.

fundamental changes being wrought in the industry, no telecommunications carrier can count on "services that are not competitive" to subsidize competitive services. Advances in technology and the removal of legal barriers to entry, culminating in the passage of the 1996 Act, make any such safe harbors from competition elusive and ephemeral. No new rules are necessary to accomplish the goals of Section 254(k) of the 1996 Act.

V. CONCLUSION

In these Comments, BellSouth has shown that the price cap LECs have no incentive or ability to engage in cost shifting and discrimination against competitors. The existing cost allocation and affiliate transaction rules, which are vestiges of rate-of-return regulation, are no longer necessary and should be eliminated. In any event, there is no need or justification for the Commission to adopt burdensome new requirements to implement the 1996 Act.

Respectfully submitted,

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APPENDIX A

ANALYSIS OF:

ACCOUNTING SAFEGUARDS UNDER

THE

TELECOMMUNICATIONS ACT OF 1996

Before the Federal Communications Commission

CC Docket No. 96-150

Analysis of:

Accounting Safeguards Under the Telecommunications Act of 1996

August 1996

Introduction

- The accounting safeguards proposed by the FCC in CC Docket No. 96-150 continue the proposal developed by the FCC in CC Docket No. 93-251
- In CC Docket No. 93-251, the FCC proposed that carriers record affiliate transactions (for services that were not tariffed or for which prevailing market rate was not used) at....
  - The higher of fair market value or fully distributed costs (for services provided from BST to its nonregulated affiliates) and ...
  - The lower of fair market value or fully distributed costs (for services provided from nonregulated affiliates to BST)
- ...thus requiring that companies like BellSouth conduct fully distributed cost (FDC) and estimated fair market value (EFMV) studies for all of the services provided to and by BST (which were not tariffed or valued at prevailing market rates)

Introduction

- In CC Docket No. 96-150, the FCC proposes to eliminate the prevailing market rate method of valuation, thus requiring companies like BellSouth conduct FDC and EFMV studies for all of the services provided to and by BST (except for tariffed services only)
- Although CC Docket No. 96-150 was developed to address the transactions associated with new affiliates (providing services relating to manufacturing, interLATA telecommunications, and interLATA information services), the rules resulting from this docket could effect BellSouth's prospective *and* current affiliate relationships

TB&A Analysis

- Theodore Barry & Associates (TB&A) was requested to assess aspects of the FCC's proposed rulemaking (relating to accounting safeguards needed to prevent subsidization in cases when telephone operating companies do business with their nonregulated affiliates) with respect to:
  - The cost and effectiveness of conducting EFMV studies for all (except tariffed) affiliated services provided to and by BST
  - The cost and effectiveness of conducting FDC studies for all (except tariffed) affiliated services provided to and by BST
  - The impact of the elimination of prevailing market rates as a method of valuation (in addition to the rules of valuation proposed in CC Docket No. 93-251)
  - The impact that the proposed revisions to affiliated interest rules will have on current and future BST affiliated relationships

Fair Market Valuation

- The FCC's proposal requires BellSouth to conduct estimated fair market value studies for all affiliated services (except for tariffed services)
- With respect to the services currently provided by affiliates to BST, this requires that EFMV studies be conducted for 70 services (as indicated by the BellSouth cost allocation manual)
- The degree to which it is possible to determine EFMV for these services, however, is largely dependent on the nature of the service provided by the affiliate
  - *Discrete* products or services are clearly-defined end services which can be regularly procured in a market and supplied by a number of providers; for example, there is a market for paging services
  - *Transaction-based* services are operational services which usually involve routine, repetitive, production-oriented activities (such as accounts payable), for which it is possible to clearly define a work product and request a price quote from external providers
  - *Knowledge-based* services involve planning and strategy development, are more amorphous and produce less clear work products, and are therefore more difficult to price externally

Fair Market Valuation

- The majority of services currently provided by affiliates to BST are knowledge-based services, with a lesser number of transaction-based services, and still fewer discrete products and services
- The results of estimated fair market value studies for these services most likely will be of questionable usefulness
  - Knowledge-based services are generally not outsourcable
  - For these services, the availability of potential alternative providers is relatively low
  - Further, the EFMV will be inconsistent and lack valid price comparisons

Fair Market Valuation

- The work (and cost) involved in procuring EFMV will be significant, involving considerable resources
  - Affiliate services will have to be identified, most likely in greater detail than provided in the CAM, in order for external providers to understand the nature of the service being considered
  - Potential external providers will need to be issued request for (price) quotations
  - Price quotes will have to be compared to ensure that they reflect comparable levels of effort and service
- In 1993, TB&A quantified the cost of conducting estimated fair market value studies from between $20,000 per EFMV (for a purely transaction service) to $70,000 per EFMV (for a purely knowledge-based service)

Fair Market Valuation

- For three BST affiliates providing services to BST (in 1993)...
  - BellSouth Corporation, for which about 15 services listed in the CAM required approximately 220 EFMV studies
  - BellSouth Business Systems (subsequently BBS Holdings), for which 16 services required approximately 32 EFMV studies
  - Bellcore, for which 7 services required approximately 225 EFMV studies
- ... TB&A estimated the annual recurring cost of performing the required EFMV studies to be $14.4 million
- This estimate does not include the 38 services that are provided to BST from other affiliates, nor does it estimate the cost associated with additional affiliate services (subsequent to the implementation of the 1996 Act including services to and from affiliates engaged in manufacturing, interLATA telecommunications, and interLATA information services)
- TB&A's *Analysis of Proposed Use of Estimated Fair Market Value* (filed as part of CC Docket No. 93-251), providing a detailed cost analysis, is attached

Fully Distributed Cost

- While some BellSouth entities (such as BellSouth Business Systems and BellSouth Corporation) currently have the systems and capabilities to conduct FDC studies, other entities (such as BellSouth Cellular, BellSouth Mobile Data, and BellSouth Personal Communications) do not
- In addition, BellSouth's emerging affiliates (involved in manufacturing, interLATA telecommunications, and interLATA information services) most likely will need to develop additional capabilities in order to conduct FDC studies
- The development of FDC capabilities will require an initial and ongoing investment in...
  - Enhancements to accounting systems to accommodate fully distributed cost
  - Design, development, and implementation of time reporting systems, systems to capture non-labor costs, and systems which model fully distributed costs and billing
  - Related hardware, software, and programming
  - System support and maintenance
- ...as well as the time employees must devote to tracking time, ongoing monitoring and auditing

Prevailing Market Rate

- Elimination of prevailing market rates will require BST affiliates that charge prevailing market rates to the general public to conduct both EFMV and FDC studies
  - Emerging affiliates (involved in manufacturing, interLATA telecommunications, and interLATA information services), for which BST most likely will be one of many customers, will be required to conduct such studies
  - Current BST affiliates (notably BellSouth Cellular, BellSouth Mobile Data, and BellSouth Personal Communications) that have demonstrated a prevailing market price may also be required to prepare FDC and EFMV studies
- This added requirement will result in a higher cost of doing business for these affiliates, which conduct business in highly competitive markets

Prevailing Market Rate

- EFMV studies, which involves the review of other providers and markets for a service, will likely result in a pricing point similar to the level already established under prevailing market rates
  - The extent of outside sales associated with the services provided to BST by BellSouth Cellular, BellSouth Mobile Data, and BellSouth Personal Communications ranges from 93% to 99%, representing a sizable external market
  - Prices that reflect a true external market provide the comparison point to which estimated fair market value studies aspire

Conclusions

- The elimination of the prevailing market rate method of valuation will significantly add to the costs already estimated for carriers like BellSouth to comply with CC Docket No. 93-251
- Requiring BellSouth affiliates to conduct fully distributed cost and estimated fair market value studies for all services (except for tariffed services) places a significant burden on BellSouth and will undoubtedly effect the competitiveness of some BellSouth companies
  - Estimated fair market value and fully distributed cost studies will add recurring fixed and variable costs, as well as implementation costs, to BellSouth companies
  - Emerging BellSouth companies preparing to enter the markets for manufacturing, interLATA telecommunications, and interLATA information services will initially have a minimal market share, which will most likely result in low margins as these companies compete for market presence
  - Additional costs will have a significant effect on already low margins, an effect that will not be realized by competitors

Conclusions

- Ultimately, the additional costs associated with conducting EFMV and FDC studies may prevent BellSouth companies from doing business with BST, a market distortion driven solely by regulation and not supported by underlying economics
  - BST affiliates will most likely consider the administrative requirements and disclosure of competitive information to be unreasonable
  - The cost associated with the compliance with the FCC's rule will be viewed as damaging to competitive margins
  - BST would then procure services -- like cellular mobile services -- needed to conduct business from other providers, which charge the same price as the BellSouth affiliate
- Estimated fair market value studies likely will result in pricing points similar to a prevailing market rate, which is based on a sizable external market
- Thus, the burden associated with the proposed rule (in terms of the costs of conducting EFMV and FDC studies) to companies like BellSouth outweighs any benefit associated with more effective monitoring of affiliate transactions

Appendix

Overview of Services Provided To BST By Affiliates

	# of Services Provided To BST	# of Services Valued At FDC	# of Services Valued At Tariff	# of Services Valued At PMR	No Charge
BellSouth Corporation	15	11	0	1	3
BellSouth Telecommunications					
BellSouth Products	0	0	0	0	0
BellCore	7	6	1	0	0
BBS Holdings	0	0	0	0	0
BellSouth Financial Services	1	0	0	1	0
BellSouth Business Systems	3	1	0	0	0
BellSouth Communications Systems	8	5	0	3	0
BellSouth Network Solutions	4	3	0	1	0
BellSouth Applied Technologies	2	2	0	0	0
BellSouth D.C.	0	0	0	0	0
BellSouth Enterprises					
BellSouth Cellular Corp	4	0	0	3	1
BellSouth Mobile Data	3	0	0	2	1
BellSouth Personal Communications	1	0	0	1	0
BellSouth Resources	0	0	0	0	0
Sunlink	5	1	0	1	3
BellSouth Information Systems	2	2	0	0	0
BAPCO	11	5	0	3	3
Stevens Graphics	0	0	0	0	0
LM Berry	2	0	0	1	1
Intelligent Media Ventures	0	0	0	0	0
BellSouth Interactive Media Services	0	0	0	0	0
BellSouth International	0	0	0	0	0
BellSouth E.C. Holdings					
BellSouth.Net	1	1	0	0	0
BellSouth Corp Aviation and Travel Services	1	1	0	0	0
TOTAL	70	38	1	17	12

Notes:

* Services listed in BellSouth's CAM as "*Less than Fully Distributed Cost" are listed here under Fully Distributed Cost

Appendix

Overview of Services Provided By BST To Affiliates

	# of Services Provided From BST	# of Services Valued At FDC	# of Services Valued At Tariff	# of Services Valued At PMR	
BellSouth Corporation	15	14	0	1	*
BellSouth Telecommunications					
BellSouth Products	12	10	1	1	
BellCore	2	1	1	0	
BBS Holdings	8	7	1	0	
BellSouth Financial Services	9	8	1	0	
BellSouth Business Systems	18	16	0	2	*
BellSouth Communications Systems	17	16	0	1	*
BellSouth Network Solutions	7	6	1	0	
BellSouth Applied Technologies	6	5	1	0	
BellSouth D.C.	4	3	1	0	
BellSouth Enterprises					
BellSouth Cellular Corp	6	4	0	2	*
BellSouth Mobile Data	1	0	0	1	*
BellSouth Personal Communications	6	3	1	2	**
BellSouth Resources	1	1	0	0	
Sunlink	1	1	0	0	
BellSouth Information Systems	3	2	1	0	
BAPCO	13	10	1	2	*
Stevens Graphics	2	1	1	0	
LM Berry	1	1	0	0	
Intelligent Media Ventures	1	0	0	1	*
BellSouth Interactive Media Services	2	1	1	0	
BellSouth International	7	6	1	0	
BellSouth E.C. Holdings					
BellSouth.Net	3	2	1	0	
BellSouth Corp Aviation and Travel Services	0	0	0	0	
TOTAL	145	118	14	13	

Notes:

* 1 service listed as PMR is actually valued as PMR and tariffed rates when applicable

** 2 services listed as PMR is actually valued as PMR and tariffed rates when applicable

*** Services listed in BellSouth's CAM as "*More than Fully Distributed Cost" are listed here under Fully Distributed Cost

Appendix

Prevailing Market Rates: Services Received By BST from Affiliates

	# of Services Provided To BST	# of Services Valued At PMR	
BellSouth Corporation	15	1	• Leased and shared office space (1155 Peachtree Associates)
BellSouth Telecommunications			
BellSouth Products	0	0	
BellCore	7	0	
BBS Holdings	0	0	
BellSouth Financial Services	1	1	• Leasing of equipment
BellSouth Business Systems	3	0	
BellSouth Communications Systems	8	3	• Installation and maintenance of CPE • Technical support, call receipt, remote testing • Programming, traffic studies, and implementation of new databases for remotely accessible systems
BellSouth Network Solutions	4	1	• Electronic mail
BellSouth Applied Technologies	2	0	
BellSouth D.C.	0	0	
BellSouth Enterprises			
BellSouth Cellular Corp	4	3	• Sales of equipment • Rental of equipment • Cellular mobile service
BellSouth Mobile Data	3	2	• Wireless data network services • Wireless data system application support
BellSouth Personal Communications	1	1	• PCS mobile service
BellSouth Resources	0	0	
Sunlink	5	1	• Leased office space (CSL Chastain)
BellSouth Information Systems	2	0	
BAPCO	11	3	• Advertising through promotional insert plan ("Delivers More") • Advertising through Yellow Pages plans and features • Advertising certificates
Stevens Graphics	0	0	
LM Berry	2	1	• Directories of other telephone companies
Intelligent Media Ventures	0	0	
BellSouth Interactive Media Services	0	0	
BellSouth International	0	0	
BellSouth E.C. Holdings			
BellSouth.Net	1	0	
BellSouth Corp Aviation and Travel Services	1	0	
TOTAL	70	17	

Appendix

Prevailing Market Rates: Services Received By Affiliates from BST

	# of Services Provided From BST	# of Services Valued At PMR	
BellSouth Corporation	15	1	• Telecommunications services including official communications
BellSouth Telecommunications			
BellSouth Products	12	1	• Bill inserts
BellCore	2	0	
BBS Holdings	8	0	
BellSouth Financial Services	9	0	
BellSouth Business Systems	18	2	• Telecommunications services including official communications • Leased office space
BellSouth Communications Systems	17	1	• Telecommunications services including official communications
BellSouth Network Solutions	7	0	
BellSouth Applied Technologies	6	0	
BellSouth D.C.	4	0	
BellSouth Enterprises			
BellSouth Cellular Corp	6	2	• Telecommunications services • Network access for cellular service
BellSouth Mobile Data	1	1	• Telecommunications services
BellSouth Personal Communications	6	3	• Telecommunications services • Network access for PCS customers • Bill inserts
BellSouth Resources	1	0	
Sunlink	1	0	
BellSouth Information Systems	3	0	
BAPCO	13	2	• Telecommunications services • Bill inserts
Stevens Graphics	2	0	
LM Berry	1	0	
Intelligent Media Ventures	1	1	• Telecommunications services
BellSouth Interactive Media Services	2	0	
BellSouth International	7	0	
BellSouth E.C. Holdings			
BellSouth.Net	3	0	
BellSouth Corp Aviation and Travel Services	0	0	
TOTAL	145	14	